In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No. 591

PACIFIC NATIONAL BANK OF SAN FRANCISCO (a national banking association), et al.,
Petitioners,

vs.

MERCED IRRIGATION DISTRICT,
Respondent.

BRIEF FOR RESPONDENT, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

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[illegible] PRINTING CO., SAN FRANCISCO, CALIFORNIA

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STATEMENT OF CASE.

The record is a long and often tragic story of the District's financial difficulties and its efforts to save itself and bondholders from total loss. The following will suffice to give the background and to show the inappropriateness of certiorari.

In 1932 the District went 62.80% delinquent with a tax rate of $8.90 per $100 assessed valuation (R. 402). For the year 1933 it faced a levy of $15.60 (R. 506,

Ex. 37; R. 740). Obviously refinancing was necessary (R. 495). The power to tax was "useless"[1] and the command to do so "mere futility."[2]

The University of California was requested jointly by the District and Bondholders (R. 433-4) to make a survey of the District's tax paying ability to the end that refinancing action might be taken fairly and intelligently. This report (R. 441, Ex. 35; R. Vol. IV) (also called the Benedict or Gianinni Foundation Report) was made after nine months of careful study (R. 435), is scientific and impartial, was thoroughly explained by its author, Dr. Benedict (R. 432-494), and was particularly relied on by the trial judge (R. 176) and the Circuit Court (R. 1060) in determining that the plan is fair. The survey disclosed that even when agricultural prices were comparatively high, assessments in considerable measure were not being yielded by the lands (R. 440-442, 456).[3] They came from outside sources—money borrowed, surpluses of corporations, savings accounts. When these were exhausted, collapse was inevitable. A letter signed by members of the Bondholders' Committee (R. 506, Ex. 37, R. 736-754), including petitioners Milo W. and Reed J. Bekins,[4] is eloquent evidence of the District's critical financial condition and the basic causes underlying its inability to carry the existing bonded debt.

A temporizing plan to extend maturities fifty years with some interest adjustment (R. 506, Ex. 37; R. 749)

1. Per Chief Justice Hughes in *U. S. v. Bekins*, 304 U. S. 27 at 54.
2. Per Justice Cardozo in dissenting opinion in *Ashton v. Cameron County Water Imp. Dist.*, 298 U. S. 513 at 534.
3. See also R. 462, 463, 471.
4. Petition pp. 21-22.

met with indifferent success (R. 497, 499). Later came appropriate legislation and the Reconstruction Finance Corporation[5] offer to refinance at $515.01 cash for each $1000 bond (R. 497-8).

The Bondholders Committee submitted this latter plan to the bondholders without recommendation (R. 498). Out of a total of 1200 bondholders 658 voted for it, 141 against (R. 503). In amount $10,221,000 voted for, $1,147,000 against (R. 499). By October, 1935, nearly 90% of the bonds had been deposited under the plan (R. 344). Pursuant to contractual arrangements with the District which meticulously provided that the old bonds were to be kept alive until refinancing was complete (R. 343, Ex. 9, Vol. OO, pp. 217-221), the R. F. C. directed the Federal Reserve Bank to purchase the deposited bonds for its account (R. 344, Ex. 10; R. 557). There followed the first trial and confirmation of the plan (R. 343, Vol. OO, p. 222) under the bankruptcy law, subsequently held unconstitutional,[6] thereby resulting in reversal of the judgment.[7] Then came a proceeding under a State act[8] enacted prior to the present Municipal Bankruptcy Composition Act. By March, 1938, the State Court had proceeded so far as to announce a decision on the preliminary features of that proceeding (R. 381) thus laying the legal foundation provided by the State act for condemnation of the dissenting bonds (R. 1028). On April 25, 1938, the Composition Act was upheld as applied to exactly the Merced type of California irri-

5. Referred to throughout this brief as R. F. C.
6. *Ashton v. Cameron County Water Imp. Dist.*, 298 U. S. 513.
7. 89 Fed. (2d) 1002.
8. Irrigation District Refinancing Act, California Stats. 1937, Chap. 24.

gation district[9] and thereupon these proceedings were originated in June, 1938 (R. 8, 36). Again followed a long trial. Every phase of the District's finances, its past and anticipated revenue, including power income (R. 407-8), expenses of maintenance and operation (R. 513) and cost of servicing the proposed R. F. C. refunding bonds (R. 343, Vol. OO, pp. 202, 206) was inquired into and the plan confirmed.

This much can fairly be said: The bonds would have had little value except for the underwriting of the District by the R. F. C. In large measure the value was then already gone. The plan and support accorded by the R. F. C. enabled the bondholders to salvage over 50% of their principal and represented the final culmination of their efforts to protect their investment before all value was destroyed. Petitioners, however, seek 100% primarily upon the theory that the R. F. C. has already refinanced the District, presumably for their benefit, and thereby cut the principal debt structure nearly in half.

ARGUMENT.

I.

GRANTING EVERYTHING CLAIMED IN THE PETITION, IT SHOULD NEVERTHELESS BE DENIED FOR THE FOLLOWING REASONS:

(a) No conflict among the circuits or the applicable decisions is asserted or exists. There is no showing that the writ is necessary to enable this court to main-

9. 11 USCA Secs. 401-404; *U. S. v. Bekins*, 304 U. S. 27.

tain uniformity of decision or to exercise a measure of supervisory control. Indeed all rulings on the Municipal Bankruptcy Composition Statute have been singularly consistent.[10]

It is not even claimed that there are "diverse decisions in the District Courts" or cases pending in which action is awaiting authoritative settlement as in *U. S. v. Constantine,* 296 U. S. 287, 290, or that "litigation elsewhere with a resulting conflict of decision" is "improbable" as in *Schriber-Schroth Company v. Cleveland Trust Co.,* 305 U. S. 47, 50.

(b) The petition does not suggest a "grave question of vital importance to the public" (*Southern Pac. Co. v. North Carolina Pub. Serv. Co.,* 263 U. S. 508, 509) or indeed any important question at all. No question of general or local law, no issue of inherent public significance, nothing colorably within the purview of Rule 38 is advanced.

(c) In short, the record evidences only run-of-the-mill litigation and the writ is asked merely to correct

10. 8th Circuit:
Leuhrmann v. Drainage Dist. No. 7, 104 F. (2d) 696 (cert. denied 308 U. S. 604).

5th Circuit:
American Nat. Bank of Nashville v. City of Sanford, 112 F. (2d) 435 (cert. denied Oct. 14, 1940, 85 L. Ed. Adv. Op. 70);
Davis v. City of Homestead, 112 F. (2d) 438 (cert. denied Oct. 14, 1940, 85 L. Ed. Adv. Op. 70);
Vallette v. City of Vero Beach, 104 F. (2d) 59 (cert. denied 308 U. S. 586);
Supreme Forest Woodmen v. City of Belton, 100 F. (2d) 655;
Getz v. Edinburg, 101 F. (2d) 734.

9th Circuit:
See group of cases decided contemporaneously with Merced as follows:
Lindsay-Strathmore Irr. Dist., 114 F. (2d) 680;
Palo Verde Irr. Dist., p. 691;
James Irr. Dist., p. 685;
Corcoran Irr. Dist., p. 690; and
Newport Hts. Irr. Dist., p. 563, plan rejected as unfair.

alleged errors arising out of a highly debatable set of facts. The questions relate to particular contracts and involve conflicts of evidence and "turn upon the facts of the particular case".[11] Clearly the writ is designed simply to review the evidence and inferences drawn from it (*General Talking Pictures Corp. v. West Elec. Co.*, 304 U. S. 175, 178)[12] and to give the "defeated party in the Circuit Court of Appeals another hearing" (*Magnum Imp. Co. v. Coty*, 262 U. S. 159, 163).

(d) Furthermore, it does not appear in the petition that petitioners seasonably raised the point which they now urge with greatest emphasis, i. e., that the finding that the plan was "fair, equitable and for the best interest of its creditors" was not a finding of fact.

In the opinion of the Circuit Court there is no such indication. In the District Court in the formal objections made by petitioners to the signing of the findings of fact the proposed finding of fairness is objected to (R. 196) and the claim is made that the evidence fails to sustain it (R. 198), but it is not objected that it is not a finding of fact. A formal request for finding of fact is made by petitioners as follows: "That the plan of composition * * * is (1) unfair (2) inequitable (3) not for the best interests of the District's creditors * * *" (R. 201). In other words, the request is for the exact negative of what the court actually found and what petitioners now assert is a conclusion of law. Finally in some 116 detailed assignments of error (R.

11. See 20 A. B. A. J. 341 per Chief Justice Hughes.
12. See also *National Labor Relations Board v. Waterman Steamship Corp.*, 309 U. S. 206.

283-307) not one charges that the finding of fairness was not a finding of fact or that the court made no finding on fairness, although error is claimed in the finding that the plan is fair for reasons therein set forth.

II.

THE PETITION SHOULD ALSO BE DENIED BECAUSE, WITHOUT DISCUSSION OF THE MERITS, OR MORE THAN A CURSORY EXAMINATION OF THE VOLUMINOUS RECORD, THE FOLLOWING SUFFICIENTLY APPEARS:

(a) The District Court in its formal findings of fact found the plan of composition was "fair, equitable and for the best interests of its creditors" (R. 214). This is a finding of the ultimate fact. And considering the innumerable, diverse and complicated elements which enter into the question of the ability of a public agency to pay its bonds, it is difficult to see how the fact could be better found without writing a treatise.[13]

Doubtless it is a question of law whether the evidence on ability to pay sustains the findings. But that test was met. Moreover the District Court expressly incorporated its opinion or "Conclusions of the Court" into the formal findings (R. 210), and says:

> "At the time default occurred in the bonds in 1933 the land of the district as a whole did not and could not be made to pay its cost of operation * * *. And according to credible testimony * * *

13. "The capacity of a debtor municipality or taxing district to pay, which is the supposed basis of any fair plan, is at best a matter of very technical estimate based on a great many problematical future variables. Even assuming possession of all the facts as of a certain date bearing on this capacity to pay, there is nevertheless always room for a very wide difference of estimates when that is projected over a future period of years." (Douglas—Democracy & Finance—1940, p. 226.)

> the productivity of the land * * * and its revenue is little, if any, better than it was in 1933" (R. 175).

Petitioners say the District Court "rejects" their contention that power revenue is to be taken into account. This is incorrect. What the court said was that the

> "* * * experiences of the past, as shown by the record before us, do not warrant a finding that power revenue conditions similar to those existing will continue in the future * * *" (R. 178-9).

Finally the Circuit Court reviewed the case, including the question whether the District could "stand either higher taxes or tolls" (R. 1043); effect of "pyramiding" delinquencies upon "diminishing tax paying acres" (R. 1042); question of insolvency (R. 1055-1056) and ability to pay in general (R. 1058-1060) and made its own finding as follows:

> "The testimony * * * amply supports the conclusion that 51.501 cents on the dollar is fair and equitable and all that could reasonably be expected in all the existing circumstances" (R. 1060).

It can now scarcely be questioned that there is a factual determination of fairness.

(b) Failure to find value of District assets (petitioners call them "corporate" assets) was not error. Petitioners have no lien or claim on District assets.[14]

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14. In *Peoples State Bank v. Imperial Irr. Dist.* Apr. 16, 1940, 99 Cal. Dec. 317, 101 Pac. (2d) 466 at 469, the California Supreme Court says: "We held, * * * that irrigation districts 'are agencies of the state whose functions are considered exclusively governmental; their property is state owned, held only for governmental purposes; they own no land in the proprietary sense, within the rule of defendant's cases.'"

These consist in the main of reservoir, power plant incident thereto, water rights and canals (R. 424). As is usual with public properties they are capitalized at cost. $5,500,000 represents the cost of moving a railroad (R. 424)—one reason for default (R. 510). Cost of such assets less depreciation can have only incidental evidentiary bearing on ability to pay. Unless lands produce sufficient revenue to pay costs of operation and maintenance, canals become clogged up, water rights are lost and the system has no going value because there are no paying lands to serve.

(c) Failure to find value of landowners' property was not error. The bondholders' right was mandamus to compel the levy of an assessment as petitioners point out (p. 5). They have no lien on the land (R. 1053).

Moreover, land in an irrigation district which is encumbered by a bond issue in excess of its ability to pay cannot have substantial value. An assessment must be levied each year for the current obligations plus the preceding delinquencies which results in "pyramiding" debts upon diminishing tax paying acres (R. 1042) with the result that in the end nobody can pay and nobody will buy land in or from the District.[15] Even assuming that the bond issue was put upon an "ability to pay" basis, according to the Benedict Report the land would have a value of only $10,518,307.00 (R. 441, Vol. IV, p. 128).

15. Pyramiding is described in *Provident Land Corp. v. Zumwalt*, 12 Cal. (2d) 365, 85 Pac. (2d) 116 at 118, as follows: "* * * If delinquency occurs a higher assessment may be levied thereafter to make up the loss, and meanwhile the district may proceed to sell the land of the delinquent owner and buy it in. If a heavy delinquency occurs, the remaining land bears a correspondingly heavy burden, for every parcel is liable ultimately for the entire bonded indebtedness, and assessments may therefore be 'pyramided' on the land which is not in default. * * * Moreover, there were no purchasers for the lands taken in by the districts, because a new landowner would immediately become liable for assessments, which could be pyramided to any extent."

(d) That the trial court on the issue of fairness gave some weight to the consents is not error. Even if the consents were incompetent, the question would still remain whether the evidence, exclusive of the incompetent testimony, was sufficient to support the finding.[16] But they were not incompetent. Perhaps by themselves alone they would not establish fairness. But they should be considered with all the other facts. And it is not alone the consents which are important but the whole background of the plan, the processes by which it was negotiated and the methods by which consents were obtained. The record is definite that negotiations were openly, fairly and honestly conducted and the bondholders themselves (not a committee or fiscal agent) with an able, disinterested study of the State University before them, decided the issue by referendum (R. 499) in glaring contrast with the method condemned by this court in *American etc. Life Ins. Co. v. City of Avon Park* decided November 25, 1940. Here there is not a suggestion of coercion, oppression or fraud. And the $515.01 payment was a net amount to the bondholders. There was no deduction for Committee expense (R. 498).

(e) Petitioners overlook that this proceeding is for composition (we have been unable to find the words "reorganization" or "readjustment" in Chapter IX) and it is composition which is stressed in the decision upholding constitutionality.[17] The difference between "composition" and "reorganization" is also referred

16. See:
National Ben Franklin Ins. Co. v. Stuckey, 86 F. (2d) 175, 176;
U. S. v. Blumenthal, 77 F. (2d) 219, 221.
17. *U. S. v. Bekins*, 304 U. S. 27.

to in footnote 14, p. 119, *Case v. Los Angeles Lumber Products Co.,* 308 U. S. 106. Obviously in a public agency there cannot be foreclosure, sale or distribution of assets. "Composition" partakes of the nature of a contract and results "in the main" from voluntary acceptance by the creditors.[18]

In *Leuhrmann v. Drainage Dist. No. 7,* 104 F. (2d) 696 (cert. denied 308 U. S. 604) the court quotes Finding No. 60 (p. 702) that about 97% of the bonds had consented to the plan and that such acceptance was binding upon the minority, and says (p. 703):

> "* * * The amount of 25.879 cents on the dollar to be paid on outstanding indebtedness is found, and appears to be, fair and equitable, and 'all that could reasonably be expected under all the existing circumstances.' It appears that some of these bonds had theretofore sold for as little as five cents on the dollar. An overwhelming statutory majority of creditors of all classes have accepted the plan, and, in our judgment, the decree of the district court approving it was right and should be affirmed."

Apparently appreciation in the value of the bonds plus consent was deemed to establish fairness. In the *Merced* case we have both of those elements[19] and much more.

(f) The claim that the State has not cooperated is best answered in the *Bekins* case (supra) at page 53, as follows:

18. *Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555, 585.

19. Merced bonds were as low as 16¢ and 18¢ on the dollar in 1932 before R. F. C. offer (R. 500).

> "In the instant case we have cooperation to provide a remedy for a serious condition in which the States alone were unable to afford relief. Improvement districts, such as the petitioner, were in distress. Economic disaster had made it impossible for them to meet their obligations. As the owners of property within the boundaries of the district could not pay adequate assessments, the power of taxation was useless. The creditors of the district were helpless. The natural and reasonable remedy through composition of the debts of the district was not available under state law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by state legislation. The bankruptcy power is competent to give relief to debtors in such a plight and if there is any obstacle to its exercise in the case of the districts organized under state law it lies in the right of the State to oppose federal interference."

(g) The asserted errors respecting the status of the R. F. C. and the payment to that agency of 4% interest are meaningless in the light of the unambiguous provisions of the bankruptcy act and the clear intent of the parties as shown by their contracts. These matters are fully discussed and disposed of by the opinion of the Circuit Court (R. 1032)[20] as are alleged errors relating to *res adjudicata* (R. 1019); pendency of the State proceeding (R. 1027), and other matters.

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20. See also *American National Bank v. City of Sanford*, 112 F. (2d) 435 (cert. denied Oct. 14, 1940, 85 L. Ed. Ad. Op. 70) decided after argument in harmony with the decision in the court below respecting sub-section (j) (R. 1036).

CONCLUSION.

Because there are (a) no conflicts to harmonize (b) no important questions of law to determine and (c) because none of the alleged errors exist, the petition should be denied.

Dated, Sacramento, California,
December 9, 1940.

Respectfully submitted,
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ANSWER TO PETITION FOR A REHEARING.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

The petition for a rehearing filed herein is not supported by the record on file and is factually inaccurate as to the evidence. It consists of mere vague and general assertions as to what petitioners contend (erroneously) was the evidence.

In refutation of the allegations in the petition, and for reasons why certiorari should not be granted, respondent refers to its brief filed in opposition to the petition for writ of certiorari and respectfully submits that the petition for a rehearing should be denied.

Dated, Sacramento, California,
January 22, 1941.

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